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DEPARTMENT PLEASE PASS TO EB/CBA FRANK MERMOUD
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TAGS: ECON EFIN EINV IT
SUBJECT: AMBASSADOR'S PARTNERSHIP FOR ECONOMIC GROWTH - OPPORTUNITIES FOR PRIVATE EQUITY

¶1. (U) Summary. As part of the Ambassador's Partnership for Economic Growth, Italian and American experts met recently to discuss the opportunities and challenges for foreign private equity investment in Italy. There was broad agreement that foreign private equity investment in Italy is held back by cultural differences, communication problems caused by language barriers, and unrealistic expectations by foreign investors. Nonetheless, participants agreed there are tremendous opportunities for private equity investment in Italy for investors with the experience, patience, and time to work with the Italian system. Although it did not explore the technical and administrative barriers to private equity investment in Italy, the meeting laid the groundwork for future discussions which the Embassy will pursue. End summary.

BACKGROUND - THE PARTNERSHIP FOR GROWTH

¶2. (U) Although it is the world's sixth-largest market economy, Italian economic growth over the past five years has been anemic, averaging only 0.66 percent annually. GDP growth in 2005 was only 0.1 percent, with growth in 2006 projected to be 1.5 percent. An independent panel of Italian economists said June 5 that Italy's deficit in 2006 could reach by year-end 4.1 - 4.6 percent of GDP. Italy's already-high public debt is on track this year to soar to 108 percent of GDP, and Standard & Poor's and Fitch have both threatened to lower Italy's sovereign debt rating from its current AA rating.

¶3. (U) Slow growth, combined with Eurozone Stability and Growth Pact obligations to keep its deficit below 3.8 percent of GDP and debt below 60 percent of GDP, mean that the Center-Left government faces the daunting challenge of meeting growing social, welfare, and health care costs with increasingly limited financial resources. Even prior to the election of the Center-Left coalition in May 2006, there were signs financial pressures were causing Italy to relinquish its role as a leader on the world stage. The GOI budget for FY/CY 2006, for example, cut military spending and slashed Italy's foreign assistance budget by 27 percent.

¶4. (U) In October 2005, Ambassador Spogli launched "The Partnership for Growth," a transformational diplomacy program to promote dynamism in the Italian economy. The four pillars of the Partnership are: (i) to encourage increased university-private sector collaboration in research and development, strengthening technology transfer and the

creation of new companies; (ii) to broaden and deepen capital markets, especially access to venture capital and private equity ("buy-out") funds; (iii) to promote stronger intellectual property rights enforcement, thus promoting innovation; and (iv) to promote business and student exchanges to encourage further innovation and business partnerships. The Partnership, launched in a speech to the leadership of Confindustria, Italy's leading industrialists' organization, has been positively received as identifying ways the private sector can work to energize the economy.

PRIVATE EQUITY INVESTMENT OPPORTUNITIES IN ITALY
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¶5. (U) Following the launch of the Partnership for Growth, Embassy Rome and the National Italian American Foundation (NIAF) collaborated on a meeting of Italian and American private equity experts to discuss opportunities for private equity investment in Italy by American firms and the obstacles that discourage foreign private equity investment. On June 20, the Embassy arranged a "Private Equity Roundtable," which brought together Italian and American lawyers, investment bankers with private equity experience, and accountants who have advised foreign investors in Italy.

¶6. (U) According to a roundtable presentation by Giampo Bracchi, President of the Italian Private Equity and Venture Capital Association, Italy is ripe for an increase in "buy-out" investment, in which an investor buys a controlling share in a company from the individual or family owning it. Some 58 percent of Italian companies are family-owned. Of these, 52.7 percent are headed by entrepreneurs over 60 years of age. Family-owned companies in Italy have a "mortality rate" of 50 percent in the second generation of ownership,

and 15 percent in the third generation. These statistics, in tandem with Italy's very low birth rate, illuminate the generational crisis among Italian entrepreneurs. The generation which rebuilt the Italian economy after the Second World War is now making way for the next generation. Often, however, the owners of these family businesses have no heir -- or a willing heir -- to take over the business. While private equity financing offers a way to preserve the firm, roundtable participants concluded that private equity investment in Italy had not lived up to its potential and is not well-understood because of differences in communications and corporate culture.

MISUNDERSTANDINGS AND COMMUNICATION

¶7. (U) Roundtable participants agreed that part of the reason that private equity investment in Italy has not reached the levels it has in other European countries is because of misunderstandings as to what private equity investment is and what it can do for a company. Traditionally, Italian family-owned businesses remain within the founder's family, and Italian entrepreneurs tend to be suspicious of external investment sources. Many Italian entrepreneurs believe private equity firms will break up a company once they have control, and that selling out to a private equity investor will cause the entrepreneur to lose control over the company he has spent a lifetime building. Many roundtable participants pointed out that while these generalizations are true, they are not an exclusively Italian phenomenon, and that private equity investment faced similar barriers in the United States in the 1960's and 1970's. These misconceptions can be addressed through outreach to business associations, to which these family businesses belong, to improve business owners' understanding of what private equity investment is and the positive effects it can have for a family business through providing increased capital and management expertise.

¶8. (U) Roundtable participants identified the second type of

misunderstanding as coming into play after an Italian company has decided to enter into buy-out negotiations with a private equity firm and when both parties, the entrepreneur and the investor, do not make clear at the outset what they want out of the investment process. One participant explained that he had spent two years working on a buy-out deal, only to have it fall through when the entrepreneur realized the ultimate goal of the private equity investor was to take the company public. One roundtable participant stated that "clarity of intent avoids 90 percent of misunderstandings."

ITALY IS ON THE CUSP . . .

¶9. (U) The consensus at the roundtable, among both Italian and American experts, is that private equity investment in Italian companies is on the verge of taking off. All foreign private equity firms which are already present in the Italian market are making a profit here and intend to stay. Many participants pointed out there are many Italian companies that are ideal for "buy-and-build" investing. Furthermore, as Italian capital markets grow, there will be opportunities for private equity investors to take their companies public through a stock exchange listing, the usual progression of a private equity investment in the United States.

. . . BUT BUREAUCRACY IMPEDES INVESTMENT

¶10. (U) Predictably, roundtable participants lamented the effect that the bureaucracy has on investment. Guido Lombardo of the Fortress Investment Group (FIG), stated that rules to regulate investment and business transactions abound, but are administered arbitrarily, resulting in "systematic demotivation" of investors and businesses. Sarah Pinto, an attorney with Latham and Watkins, noted that stock exchange listings that should be processed within 60 days are routinely delayed by bureaucratic inefficiency. Other participants noted prospective investors can be deterred by Italy's bureaucracy, high labor costs, high taxes, and poor infrastructure.

¶11. (U) Comment: Comments during the roundtable confirmed

the conventional wisdom as to why there is not more private equity investment in Italy. What was unique about this event was that it brought together key players in an atmosphere conducive to a frank exchange of views. Many participants noted that it was the first time that the problems and opportunities in Italy had been set out in such a straight-forward manner. Participants said they look forward to more technical follow-up discussions.

¶12. (U) Comment continued: The roundtable succeeded in launching the private equity component of the Partnership for Growth by bringing together American and Italian experts in private equity, and making the American participants more aware of opportunities in Italy and how best to deal with obstacles that have discouraged investment in the past. NIAF and the American Chamber of Commerce have begun planning for a "private equity fair," to be held in Milan this fall. At the event, private equity companies will explain what private equity investment is and how it can benefit privately-held companies. Companies will also present their products and business plans. Organizers hope companies and potential investors make connections that lead to investment deals. If the event is successful, NIAF and the Chamber plan to hold a series of private equity fairs in different parts of Italy. End comment.
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